



*Rosalind M. Hewsenian*  
*Managing Director*

October 21, 2005

Mr. Mark Anson  
Chief Investment Officer  
California Public Employees' Retirement System  
400 Q Street  
Sacramento, CA 95814

Re: International Fixed Income Managers Annual Review<sup>1</sup>

Dear Mark,

You had requested Wilshire's opinion with respect to Staff's recommendation pertaining to the annual renewal of the contracts of the international fixed income managers. Wilshire concurs with Staff's recommendations, though we are closely monitoring two managers.

### **Discussion**

Over the year ending August 31, 2005, the CalPERS International Fixed Income program outperformed its benchmark. In addition, the program, which was initiated in August 2000, has outpaced the benchmark since inception. Staff has made adjustments to the program during the year, one of which was the resignation of Wellington, an underperforming manager. Staff is also planning a Request for Proposal to add a spring-fed pool of managers to provide more flexibility and diversity to the program. We support the annual contract renewal recommendation as the current stable of managers has produced positive active returns over the last year, with the exception of Baring, which we are monitoring. In addition, two other firms, Bridgewater and Western Asset, are going through organizational changes. We are currently monitoring these managers closely, too.

Discussions of the three managers are shown below.

### **Baring Asset Management**

Barings' investment management approach is team oriented and seeks to add value through country selection, yield curve positioning, currency hedging, and credit selection. The manager was hired in October 1989 and has the longest tenure of all of the external international fixed income managers. The manager slightly underperformed its benchmark over the year ending August 31, 2005 due to unfavorable currency selection

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<sup>1</sup> Wilshire's Code of Conduct requires us to disclose which firms are clients of Wilshire's Analytics Services Division. This disclosure has been delivered under separate cover.

and duration positioning. However, since inception, the manager has produce strong annualized active return of 1.63%. In addition, the investment philosophy has remained stable over the years. Therefore, Wilshire is not concerned at this time, but will continue to work with Staff to monitor the manager to ensure there is no further deterioration in performance.

### **Bridgewater Associates**

Bridgewater uses a fundamental and systematic investment process that is applied to each client on a tailored basis. The manager first builds an index portfolio that replicates the client's index, and then based on systematic assessment of market pressures, it makes selections between various sectors, countries and individual bond issues to add value. Over the year ending August 31, 2005 and since inception, Bridgewater has added value versus its benchmark. However, Bridgewater has had a high-level personnel change recently with the departure of its CEO, Britton Harris. Mr. Harris was in the position for less than one year and resigned because he was unable to adjust to the firm's flat structure, which is the hallmark of the firm and why it has been very successful. The departure of Mr. Harris does not concern Wilshire at this time. Bridgewater is currently working on finding a replacement for Mr. Harris. Wilshire will continue to work with Staff to closely monitor the situation to ensure that there is no future impact to the firm from this departure.

### **Western Asset Management**

Western Asset's investment approach combines traditional analysis with technology applied to all sectors of the market. The approach seeks to achieve diversification by ensuring a balance across four main areas: duration and term structure, country/currency allocation, sector allocation, and issue selection. The manager has added value versus the benchmark since inception and was the best performing external international fixed income manager over the year ending August 31, 2005. However, significant organization change is expected with the recent merger between Legg Mason, the parent of Western Asset, and Citigroup Asset Management. The deal is expected to close at the end of November and Western Asset is expected to receive the majority, if not all, of the fixed income assets managed by Citigroup Asset Management. Because both Legg Mason and Citigroup are publicly traded companies, Western Asset has indicated that no announcements are expected until after the deal closes. Wilshire has set up a meeting with high-level management of Western Asset for December and will provide to CalPERS our evaluation of Western's asset merger. We recommend no action at this time.

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### **Conclusion**

While Wilshire is closely watching the three managers mentioned, Wilshire concurs with Staff's recommendation to renew the contracts for all of the international fixed income managers, as CalPERS still has the right to terminate on 30 days' notice.

Sincerely,

A handwritten signature in black ink, appearing to read "R. M. Hensenian". The signature is written in a cursive style with a large, stylized "R" and "M".